Governance Institute of Australia

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Director
Continuous Disclosure Review Unit
Market Conduct and Digital Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: continuousdisclosurereview@treasury.gov.au

Dear Sirs,

Consultation Paper - Continuous Disclosure: Review of changes made by the *Treasury Laws Amendment (2021 Measures) No. 1 Act 2021* (Consultation Paper)

Governance Institute of Australia

Who we are

Governance Institute of Australia (Governance Institute) is a national professional association, advocating for our network of 43,000 governance and risk management professionals from the listed, unlisted, public, not-for-profit and charity sectors.

As the only Australian provider of chartered governance accreditation, we offer a range of short courses, certificates and postgraduate study. Our mission is to drive better governance in all organisations, which will in turn create a stronger, better society.

Our members have primary responsibility for developing and implementing governance frameworks in public listed, unlisted and private companies, as well as not-for-profit organisations and the public sector. They have a thorough working knowledge of the operations of the markets and the needs of investors. In preparing this Submission we have consulted with our members who are company secretaries of listed companies who have first-hand daily experience of the operation of the continuous disclosure regime.

This Submission does not respond to all the questions in the Consultation Paper but concentrates on the issues of interest and concern to our members.

Executive Summary

Our members supported the 2021 Amendments.[1] This was because they considered the changes would ensure a more appropriate balance between protecting the interests of shareholders and the integrity of

[1] See Submission to the Senate Economics References Committee, *Treasury Laws Amendment (2021 Measures No.1) Bill 2021*, Governance Institute of Australia, 28 May 2021.

the markets, while reducing the likelihood of class actions that did not seek to promote higher standards of market disclosure. At the time they considered that the 2021 Amendments would not materially change the nature of disclosure obligations, specifically what needs to be disclosed and by when because they require that knowledge, recklessness or negligence needs to be proven to establish liability against a company or its officers in civil penalty proceedings.

In summary, GIA considers the 2021 Amendments should be retained because:

- Australian listed companies are subject to a disproportionately higher risk of class actions, relative to their peers in overseas jurisdictions

- The constant threat of cyber-attack and data breaches and the imminent introduction of mandatory climate-related financial disclosure have changed the landscape. In a cyber incident the information available changes rapidly and there is an expectation that companies will communicate with their customers, clients and other stakeholders. What constitutes a 'material impact' on company's share can be very difficult to determine, particularly in the early stages of an incident. The imminent introduction of mandatory climate-related financial disclosure will require the disclosure of forward-looking information and projections based on information and assumptions that may well become out of date or inaccurate very quickly. These developments which were not in place when the 2021 Amendments were passed leave Australian companies unreasonably exposed to potential class actions, and

- Repeal of the 2021 Amendments is likely to lead to the cost of Directors and Officers (D&O) Liability insurance for Australian entities increasing to the point where it is no longer affordable, or even available, for many companies, potentially leading to an exodus of experienced non-executive directors unwilling to operate in an uninsured environment.

Preliminary remarks

The Consultation Paper does not address the fact that the continuous disclosure provisions operate within a broader regulatory framework. This framework includes directors' duties under the Corporations Act and the common law and the misleading and deceptive conduct provisions under the Competition and Consumer Act. All of these provisions were in place when the 2021 Amendments were passed and remain in place and are unaffected by those amendments and provide a number of avenues to take action against directors for a breach of duty.

Our members working in global companies report that the Australian continuous disclosure provisions impose a much higher bar on Australian listed companies, especially in relation to the immediacy of the disclosures required, than in overseas markets. They do not consider that the 2021 Amendments have led to a decline in the quality of disclosures or a less efficient, effective or informed market, particularly when compared to overseas jurisdictions.

Anecdotally most companies are proceeding as they always have with the same level of diligence. The 2021 Amendments provide that if a reasonable and considered judgement is made which with 20/20 hindsight turns out to be wrong, noting the unpredictability and volatility of the markets, the company will be less likely to be subject to a class action.

Specific issues

Class Actions

As noted in our previous Submission the class action landscape in Australia is a significant concern for companies and officers seeking to manage their continuous disclosure obligations. Despite their best

endeavours, market reaction to information is unpredictable and determining whether information will have a material impact on the price of securities is not a precise science. While ASX Guidance Note 8 – Continuous Disclosure is comprehensive and helpful, our members' experience indicates that continuous disclosure issues are rarely black and white, and most companies err on the side of over disclosure due to concerns around class actions. At times, this can be commercially damaging, thereby negatively impacting shareholder value. Conversely, if information is not disclosed despite an appropriate assessment being undertaken by a company and its officers and there is subsequently a significant movement in the share price, a significant class action exposure may arise. In Australia, that exposure has a high likelihood of resulting in a settlement in Australian proceedings, notwithstanding fault may not have been established because of the full consideration of the issues by a court.

Our members also consider the 2021 Amendments bring Australia more in line with other global capital market practices. Australia is a global outlier in terms of securities class actions, particularly given the liability regime under current continuous disclosure laws. Our members consider that it may be too early to assess the impact of the 2021 Amendments on the ability to bring class actions in relation to securities matters. However, they note that a recent Report indicates that while the number of class actions brought in 2022/23 was lower than in the highest year reviewed to date (2020/2021), 53 as opposed to 65 claims, the number of securities related class actions was relatively consistent with previous years.[2] This Report also notes that the number of settlements approved during the period reached $1B, for the first time since 2019/20.

Cyber-attacks and data breaches

While the COVID-19 pandemic accelerated the uptake of technology in all sectors it has brought with it an exponential increase in the threat of cyber-attack. Most Australians have been impacted by a data breach. Australian companies are keenly aware and are regularly reminded by regulators that companies in all sectors are under attack from cyber criminals and nation state actors.[3] ASIC has indicated an appetite to prosecute companies for breaches of the continuous disclosure regime.[4]

During a cyber-attack, events evolve rapidly and the information available changes from hour to hour. There is also an expectation that companies under attack, or which have suffered a data breach will communicate with their clients, customers and other stakeholders.

As noted by King&Wood Mallesons in a recent article 'ASX listed companies face an added layer of complexity arising from their continuous disclosure obligations, and must be prepared to manage those obligations if a material cyber incident arises. The financial, legal and reputational implications of a failure to adequately disclose are potentially significant, including having regard to the potential for a significant cyber incident to materially impact share price.'[5] As the article notes what constitutes a 'material effect on price or value' in the context of a cyber incident can be very difficult to determine, particularly in the early stages'. As noted above ASIC has indicated it has a strong focus on companies' cyber resilience and ASX has also indicated it will be monitoring cyber incidents and data breaches and the information disclosed to the market. Cyber incidents move and change rapidly. Despite every effort, what a company knows about the extent of an attack or a data breach at the onset may be completely different to the situation hours or days later. Continuous disclosure obligations will be relevant at various stages during a cyber incident. As noted above continuous disclosure is rarely black and white and will require the exercise of judgement. For this reason the requirement for an element of knowledge, recklessness or negligence to be proven to establish liability against a company or its officers in civil penalty proceedings is appropriate.

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[2] See The Review: Class Actions in Australia 2022/23, King&Wood Mallesons pages 6 – 9.

[3] See *Cyber risk: Be prepared*, ASIC 15 July 2022 and Speech *Navigating disruption: Setting a direction for ASIC in 2024*, Joe Longo, 21 November 2023.

[4] See *Only 11 of 36 hacks revealed to market: ASIC warns on disclosure*, AFR, 20 February 2023.

[5] See Walking a Tightrope: Continuous Disclosure, Data Breaches and Cyber Security, King&Wood Mallesons, 30 March 2023.

Introduction of climate-related financial disclosure

Our members also note that the introduction of mandatory climate-related financial disclosure, including the disclosure of Scope 3 emissions is imminent.[6] The first cohort of companies to report is likely to be larger listed companies. Our members note that setting Scope 3 emissions targets can be problematic, as these companies will have no or limited control over these emissions. While companies generally can have a strong degree of confidence in relation to Scope 1 and Scope 2 emissions, it is much more difficult to accurately account for all other indirect emissions that occur in a company's value chain. Often these disclosures can only be made on an estimates basis and are qualitative in nature. This will be problematic for companies where Scope 3 makes up a significant portion of their emissions profile and will necessarily involve forward-looking statements. Under Australian law forward-looking statements must be made on reasonable grounds. Given that climate change measurement is evolving rapidly companies will need to make disclosures based on information or assumptions that may well become out of date or inaccurate very quickly.

As noted above Australia is also 'the most likely jurisdiction outside of the United States in which a corporation will face significant class action litigation'.[7] A 2022 Report notes 'climate change issues are looming larger in the potential class action risk equation'.[8] It should also be noted that it is more difficult to bring class actions in the United States than Australia and a safe harbour is available in that jurisdiction for TCFD disclosures. The potential for exposing a company and its officers to a class action because of its climate-related disclosures is another factor which may disincentivise accurate, comprehensive and timely disclosure by reporting companies and may lead to a decline in the quality of disclosures or a less efficient, effective or informed market.

While the current Treasury proposals for climate-related financial disclosure indicate that there may be a modified liability regime it is not intended to make any adjustments to the continuous disclosure regime.[9] Our members are concerned about the interaction between periodic climate-related financial disclosures and the continuous-disclosure regime for ASX-listed companies. Some companies currently issue periodic sustainability reports or disclosures which include information they do not consider will have a 'material effect' on the price or the value of their securities from the perspective of continuous disclosure. These companies may, at a later point, change a pathway towards achieving net zero because the pathway becomes blocked or if it fails to reach an interim target and it has disclosed the pathway or target in a periodic report. Given the difficulty of assessing the point at which a path becomes blocked and, while this information may be important to some stakeholders, it may not necessarily be market sensitive. The climate-related financial reporting requirements will also require the disclosure of large volumes of information, much of it technical projections. There are also inherent uncertainties in relation to, for example, some of the data and the technologies underpinning emissions reductions. While Treasury indicated in the climate-related financial disclosures second Consultation Paper (p.22) that 'It is not expected that all changes to underlying assumptions relating to climate disclosure would need to be reported to the market', our members consider this understates the complexities involved in making judgements around these issues.

Given the imminent introduction of climate-related financial disclosure our members consider it is even more important to retain the 2021 Amendments. They consider that a regime whereby companies and their officers are only liable for civil penalty proceedings in respect of continuous disclosure obligations where they have acted with 'knowledge, recklessness or negligence' is appropriate. This is because the 2021

[6] See Treasury Consultation Paper Climate-related financial disclosure: Second consultation, Treasury, 27 June 2023.
[7] See Class Actions in Australia, Updated May 2022, Allens Linklaters.
[8] See Class Action Risk 2022, Allens Linklaters.
[9] See Footnote 3 above.

Amendments strike an appropriate balance between protecting the interests of shareholders and the integrity of the markets, while reducing the likelihood of class actions that do not seek to promote higher standards of market disclosure.

D&O insurance

In our Submission on the 2021 Amendments, we noted that the cost of D&O insurance had increased substantially in all sectors over the prior two years. Our members understood that this was mostly driven by the large number of investor class actions settled in Australia. In larger companies, board related costs frequently sit in the cost centres overseen by our members. Our members are typically responsible for director induction and directors' letters of appointment which usually include the terms on which companies provide D&O cover for directors. D&O insurance is generally a critical risk mitigation mechanism for both companies and their officers.

Anecdotal evidence from our members indicates that the D&O insurance market has settled since 2020/21. At that time, the significant increase in the cost of D&O insurance had resulted in many companies seeking to reduce or altogether eliminate Side C cover, which provides protection to companies in relation to securities class actions. This was problematic because markets have experienced considerable uncertainty and volatility over the last few years which resulted in significant and novel challenges in managing continuous disclosure issues. Side C cover provides protection of companies' balance sheets in respect of such issues. There has also been an increase in the number of class action claims in relation to a number of data breach related class action filings, including a securities claim alleging breach of continuous disclosure obligations following a cyber-attack.[10]

Our members are concerned that given the record number of class action settlements noted above and the potential for claims relating to climate-related financial disclosures, it is likely the cost of D&O insurance will rise again, particularly if the 2021 Amendments are removed. Where companies have reduced or eliminated Side C cover, any consequential increase in losses due to securities class actions will, in many cases, be borne by continuing shareholders. This would appear counterintuitive and potentially damaging to a key stakeholder group that applicable laws are seeking to protect, especially given the prevalence of settlements that are reached in relation to such matters, where the fault of the company has not been established by a court.

Governance Institute recommends retention of the provisions which require that for ASIC to succeed in a civil penalty proceeding against or for a plaintiff to succeed in a proceeding for damages from, a disclosing company or its officers for alleged breaches of the continuous disclosure laws, they must show that the company or its officers acted with 'knowledge, recklessness or negligence'.
Please contact me or Catherine Maxwell, GM Policy and Research if you have any questions in connection with this submission.

Yours sincerely,

Megan Motto

CEO

[10] See Footnote 2.